

APFI Responds to CMA ‘Investigation and Issues into Investment Consultants’

With effect: 31 October 2017.

What: The following outlines the Association of Professional Fund Investors (APFI) initial view of the issues and remedies proposed by the CMA, which were set out in: <https://assets.publishing.service.gov.uk/media/59c376f7ed915d408c10d131/investment-consultancy-market-investigation-issues-statement.pdf>



Background: The APFI notes that the CMA has pulled extensively from the FCA Asset Management Study and subsequent UIL (‘undertaking in lieu’) proposed by the large consultancy firms. The APFI responded to FCA at the time to reject the UIL and refer the issue to the CMA. The CMA has then broadly grouped potential remedies into three categories: demand-side and informational remedies; remedies addressing potential conflicts of interest; and remedies addressing potential barriers to entry and expansion. Our response to the UIL can be found here:

<https://www.dropbox.com/s/0uebq3mijbtigu4/APFI%20Response%20to%20FCA%20UIL%20CMA%20July17.pdf?dl=0>

Our approach: The APFI recognises that this is a new area for the CMA to consider and therefore remedies and direction may take time to evolve iteratively. The CMA notes: “To help inform our initial thinking, we nonetheless welcome views from parties on potential remedies at this very early stage.”

The APFI therefore wishes to support the CMA, applying our experience in these matters to help drive outcomes that are in the best interests of end investors, the industry, agencies, gatekeepers and hitherto professional fund investors. We look forward to further engaging with the CMA before and following the publication of the Provisional Decision Report and Final Report. This is an area of great interest to our members, some of whom reside in large consultancies, others in smaller firms, research agencies, wealth managers, advisory firms, multi-managers, insurance firms and platforms. Consequently we have attempted to be balanced in our response to these interests; as well as what we believe to be in the best interests of end investors and industry.

The APFI is committed in promoting professionalism in fund research, selection and advocacy.

View: We concur with CMA that Aon Hewitt, Mercer and Willis Towers Watson are the three largest investment consultants in the UK, representing approximately 60% of the market. However a vast part of the remaining market is also heavily concentrated in terms of

ratings and selection by the likes of Morningstar and Russell investments. The CMA would do well to also consider these firms and suggest that the 60% quoted for 3 firms is equated to 75% for 5 firms and means that only a quarter of the market enjoys healthy competition. To recap, the UIL offered by the three parties to the FCA related to the following areas:

(a) changes to the tender regime for both consultancy services and fiduciary management services;

(b) public disclosure of performance in relation to manager selection and fiduciary management services;

(c) industry standards on disclosure of fees and other costs;

(d) conflicts of interest;

(e) improvements to the redress mechanism for complaints; and

(f) adherence of investment consultants to a strict code of conduct.

The APFI felt that the UIL was positive in principle but did not fully address the conflict between fiduciary and non-fiduciary services and recommending funds outside of the fiduciary perimeter and particularly recommending funds offers within the same firm. The APFI proposes that the basic rule for such practices has to be 'potential conflict exists unless evidenced otherwise'. This would require consultants to demonstrate far more robust whole of market searches before recommending internal offerings (via 'mandatory tendering').

The APFI has provided answers to questions posed by CMA as follows:

(a) Would the potential remedy be effective and proportionate in remedying any AECs that we may find in relation to investment consultancy services and/or fiduciary management services?

A) The measures proposed will alleviate the issues raised. The issues identified are symptomatic of the structure of DC pension fund governance today. Stronger fiduciary controls, professionalism, transparency and accountability are necessary to foster better competition of investment consulting.

(b) Would the potential remedy give rise to any unintended consequences or distortions?

A) Unintended consequences are always possible - the key one is to ensure that measures taken do not disadvantage smaller consultancies by raising the regulatory levy to an unobtainable point. Measures should engender better practices; not simply raise costs.

(c) Are there other potential remedies that would be as effective and proportionate in remedying any AECs that we may find that would be less costly or intrusive?

A) Better accreditation, fiduciary obligation, training for trustees and professionalism among those recommending fund managers to trustees and employers. For example bringing consultants within 'approved persons' regime is an existing structure.

(d) What are the relevant costs and benefits that we should take into account in considering the proportionality of the potential remedy? How could we quantify these?

A) The costs relating to the remedy should be scaled against a small consultancy made up of one two key staff with annual earnings of between £50,000 and £250,000 per annum.

(e) What provisions would need to be put in place for the monitoring and enforcement of the potential remedy and which body should be responsible for monitoring?

A) Monitoring should be completed in conjunction with recognised professional bodies and associations. Remedies can be entered through the T&C regime for firms. Firms should set-up advisory boards to review monitoring and progress.

(f) Should the potential remedy be time limited? If so, for how long should it apply? What type of changes in the market would warrant the variation or removal of the remedy?

A) The APFI supports the raising of professionalism and remedies should only be removed once an adequate fiduciary/governance framework is in place.

(g) Should the potential remedy apply only to pension funds and/or investment consultants of a certain size? If so, what should that threshold be?

A) In terms of short-term competition remedies then these should be applied to the top 30% of firms by size. In terms of remedies that improve professionalism and transparency (e.g. benchmarking) that support long-term competition then these should be broadly universal.

A. Demand side and informational remedies

“Insufficient information is available to trustees and employers to compare investment consultants’ fees and quality.”

A) The APFI agrees with the above statement.

“A particular concern expressed by the FCA is that trustees are insufficiently able to assess the quality of the advice that investment consultants give them or the fees that they are charging, with the result that the value for money”

A) The APFI agrees with the above statement.

“The CMA has considered potential remedies to improve transparency over fees and performance. In broad terms, this potential set of remedies would involve developing an industry standard template for the reporting of fees and performance, which would make performance, fees and hence value-for-money, more transparent and comparable across different consultants, increasing competitive pressures on fees and quality of service. The potential remedies identified below could work alone or in combination, to achieve this outcome.”

A) The APFI supports transparency around fees and performance but notes that a standard template may be difficult to implement and would need to be adopted by a much broader set of services than simply investment consultants.

“Require investment consultants to provide clear, consistent information to trustees in relation to all fees.”

A) The APFI supports better information and training for trustees. Trustees should also be required to disclose how consultants are selected.

“The CMA are considering the development of an industry standard on disclosure of all fees charged and comparison with those quoted for incumbent clients. This could involve comparing fees charged directly to fees quoted (eg at outset of a contract or during the competitive tender process).”

A) The APFI suggests that any such template should be considered in context to other cost templates being devised within the industry rather than in silo.

“Require investment consultants to report all fees to an independent benchmarking service to allow pension schemes and employers to compare their fees to the market.”

A) The APFI supports transparency but reporting must be on more KPIs than simply costs. The efficacy of the manager selection services, ratings should also be reported, measured and independently verified. Only once schemes and employers can see both value-added and cost can they determine Value for Money between service A and service B.

The CMA notes “ This potential remedy would involve the development of an industry standard for disclosure of all fees and costs incurred throughout a contract’s lifecycle and could also include establishing an independent benchmarking platform which would collate and publish this data on a regular basis, thus allowing pension schemes and trustees to compare investment consultants’ fees against other firms.”

A) The APFI supports any framework that enables smaller firms to compete with larger firms, including those available from advisory firms, fund ratings, insurance firms etc.

The CMA also notes “require investment consultants, when providing advice, to be clearer on the impact of a particular course of action on their own fees.”

A) We believe this could be easily addressed by bringing consultants into the fiduciary perimeter such as the approved persons’ regime.

The CMA notes “potential remedy would involve developing an industry standard that would oblige investment consultants to disclose the impact of a particular course of action on the fees that their clients would have to pay, following that course of action. Investment consultants would have to explain investment strategies, pricing models, etc to trustees prior to making the investments and ensure that trustees have fully understood the course of action and the impact on their investment prior to proceeding with an investment.”

A) We believe setting industry standards can have merit but risks complexity that makes comparison more difficult.

The CMA considers banning certain investment consultant pricing practices. The CMA notes “potential remedy would involve banning certain pricing models and mechanisms if they were misleading to trustees or likely to lead to perverse incentives.”

A) The APFI supports removing fee structures that are deemed misleading.

“The CMA considers if investment consultants should report on pension fund returns against agreed benchmarks.”

A) The APFI questions the use of benchmarks, which should promote long-term investing and reduce turnover versus increasing focus on short term returns, which encourages switching and herding. However some form of outcomes matching against recommendations is prudent. There are a range of approaches including absolute return targets, risk-adjusted returns, hit rates etc.

“This potential remedy would involve developing an industry standard benchmark for relative returns. This could include requiring investment consultants to report on the relative performance of the fund against this benchmark, to increase industry transparency.”

A) The APFI questions the use of benchmarks, which should promote long-term investing and reduce turnover versus increasing focus on short term returns, which encourages switching and herding. Any use of benchmarks should be investable - e.g. ETFs.

“A particular challenge, as noted by the FCA, would be how to establish a link, in such reporting, between the performance of the fund in question and the asset allocation advice provided by the investment consultant. We would welcome the views of parties on this question.”

A) We suggest the services of the consultant should be clearly measured separately in terms of fund manager search, rating and selection and asset allocation advice. These are distinct disciplines and value added in one may be detracted by the other. Reporting distinctly allows better transparency and inferior services being offset.

“Require investment consultants to report the fees of asset managers selected and give details on the extent to which they have reduced fees for the trustees”

A) The APFI supports the above remedy and believes a key part of the role of professional fund investing is to negotiate competitive commercials and evidence that some managers were de-selected on grounds of cost.

“This potential remedy would involve developing an industry standard for disclosure of asset managers’ fees and require consultants to report how and to what extent they have reduced fees for their clients.”

A) The APFI supports any measures that drive better conviction in manager selection and securing value for money. Funds priced at a premium are best supported by evidence of cost negotiation and higher conviction to deliver future excess returns to alternatives.

“Require investment consultants to report the performance of their manager recommendations based on standardised performance metrics”

A) Standardised performance metrics may engender short-termism and skewed views of success. The metrics should reflect the nature of the mandate and thus standardisation is problematic. Metrics may be better based on measures like risk-adjusted return, hit rates, win-loss ratios.

“investment consultants would be required to report their relative performance in terms of asset manager recommendations against these metrics, to increase transparency and help increase competitive pressures on performance. There is a variety of ways in which this potential remedy could be implemented. Under one variant, for example, investment consultants could report against their own performance metrics, if they choose to do so, in addition to the standardised metrics. Under such an option, it would be important to ensure that the metrics developed by the investment consultant were used consistently over time to ensure comparability over time.”

A) APFI supports any transparent means to show the value added by the consultant, particularly in terms of manager selection.

“Require pension schemes and employers to provide reviews of investment consultants, with aggregate results shared/available on websites.”

A) The APFI challenges whether schemes and employers are sufficiently skilled to make accurate objective comparisons without education or support. However in principle disclosing in this way is potentially beneficial.

“Introduce mandatory tendering for consulting, fiduciary management services and/or master trusts”

A) Comparing the competency of different consultancies and services through ‘mandatory tendering’ is supportive of promoting better professionalism in asset management.

“This potential remedy would involve introducing a mandatory tender regime for investment consultancy services, fiduciary management services and master trusts. This could happen periodically (for example every five, seven or ten years), including when seeking to procure these services for the first time. In addition, pension funds could be encouraged to review services from investment consultants and/or providers of master trusts on a regular (ie annual/biennial) basis.”

A) The APFI agrees that frequency of tendering is important to long-term investing, minimising turnover.

Establish rules to improve the tendering process

“This potential remedy would involve working alongside investment consultants and pension funds to develop a set of industry standard rules to improve the tendering process and make it more transparent. Such rules could relate to, for example: the need to attract multiple bidders; the parameters of the tender documents; the selection criteria; and the use of a third-party adviser to run the tender”

A) The principles of good mandatory tendering would follow a similar format to the search, Request for Proposal and beauty parade selection practices of professional fund investors. Industry standards are helpful but need to be backed by better education for pension funds such as the template being designed by the Transparency Task Force.

Produce standardised off-the-shelf tender documents that smaller pension schemes and employers could (but would not be obliged to) use to make tendering cheaper, easier and more effective.

“This potential remedy would involve working with pension funds and consultants to develop a set of industry standard tender documents to help smaller pension funds with

their tendering processes. Smaller pension funds and employers may not have the in-house capability and resources to develop these documents and standard off-the-shelf documents would make tendering cheaper, more transparent and effective for them.”

A) The APFI notes similar services available digitally for fund due diligence questionnaires e.g. www.DOORfunds.com, www.InvestRFP.com, www.fundinfo.net.

“Recommend some form of aggregation/consolidation of pension trusts to benefit from economies of scale”

A) APFI notes that consolidating pension assets may support economies of scale but may also create asset concentration and should be approach with caution.

“This potential remedy would involve recommending aggregation or consolidation of trusts below a certain size and with similar investment criteria and strategies. The consolidation/aggregation could give rise to economies of scale by reducing fixed costs for the funds. We note, in this respect, that the FCA has recommended that ‘the Department for Work and Pensions (DWP)’”

A) The move to better cost transparency is wholly supported by the APFI and we note that large institutional investors can access lower prices in the market. However consolidating trusts before addressing the concentration of investment consulting is not itself helpful. This might be alleviated if consolidated schemes enlist panels of consultants who can ‘tender’ on a regular basis as suggested in the remedies. Such panels should combine both large and small consultancy firms to allow trustees gauge quality, choice and value for money.

B. Potential remedies to address conflicts of interest

We set out below potential remedies to address any AECs that we may find in relation to potential conflicts of interest. We have grouped these remedies into four categories, corresponding to different hypotheses regarding the existence of conflicts of interest.

“Investment consultants encourage clients to use their fiduciary management services and/or master trust services even if it is not in the clients’ best interests”

A) We believe the offering of internal fund offerings and fund selection services poses a conflict of interest. Recommending a vertically-integrated framework or blend should be done so on the presumption of conflict until evidenced otherwise. Here again better professionalism in terms of fund selection will alleviate the risk of conflict. This includes ensuring staff are not incentivised either implicitly or tacitly to recommend the internal product.

“Require investment consultants to give greater clarity to trustees that they are moving into a different arrangement and that they could seek this service from other firms”

A) APFI supports better clarity for trustees to make better informed decision in terms of the consultant they use, through better information but also better training and accountability upon trustees to execute. The use of qualified and experienced professional fund investors may aid trustees to make such decisions with confidence.

“This potential remedy would involve developing an industry standard whereby investment consultants commit to inform their clients of the distinction between fiduciary management services and investment consultancy services. Investment consultants would have to advise consultancy clients that it would be best practice to conduct a competitive tender process for fiduciary management services. As a supplementary measure, the remedy could involve developing an industry standard whereby investment consultants

commit to provide their clients with ‘cost benefit’ analyses for different options available to them.”

A) The above measure is helpful but the recommending of internal products should be segregated from the products themselves. Potentially a second consultant may be necessary to advise the trustees and firm would need to demonstrate how staff and incentives are segregated.

Require mandatory tendering of fiduciary management/master trust services

“This potential remedy would involve imposing a mandatory tender regime whereby trustees would be required to tender for fiduciary management services periodically (eg every five, seven or ten years). Under this remedy, investment consultants would also be required to encourage clients to review fiduciary management services periodically (eg every year or two years).”

A) The APFI supports this remedy and should be structured with an ongoing panel. Clients should be required to conduct mandatory tenders every 2-5 years irrespective.

“A similar remedy could apply to the selection of master trusts, whereby employers would be required to tender for the selection of a master trust scheme for their employees periodically.”

A) The APFI is supportive.

“Prohibit investment consultants from providing fiduciary management/master trust services. This potential remedy would involve prohibiting investment consultants currently offering investment consultancy services to their clients from providing fiduciary management services to those clients. A similar remedy would prohibit investment consultants advising an employer on the establishment of pension schemes from providing an in-house master trust scheme to the same employer.”

A) This remedy has the best likelihood of removing conflicts of interest presented by firms that offer fiduciary and consulting services.

Measures to control prices in relation to master trust services

“This potential remedy would involve reviewing the existing price cap in place for master trusts. We may want to consider the impact of this cap on competition and outcomes for pensioners, with a view to reviewing the level and/or scope of the cap. We note that any such remedy may address the demand-side issues identified under hypothesis A, as well as the conflicts issues under hypothesis B.”

A) Price intervention itself is complicated, promoting transparency and tendering process are likely more effective measures. Price caps tends to have unintended consequences that are hard to predict.

Bringing the supply of investment consultancy services and fiduciary management services within the FCA’s regulatory perimeter

“Currently some investment consultancy services and fiduciary management services can be provided in a way that is not regulated by the FCA. The FCA noted in its report that bringing the provision of those services within its regulatory perimeter may address some of the potential concerns, as it would be able to supervise and monitor the provision of those services. It would also give the FCA the power to implement and carry forward any recommendations or remedies that we may introduce to address any AECs that we may find. This remedy would potentially be relevant in enforcing and/or monitoring some of the conduct issues described in this category (and the sub-categories below) and may also

have relevance to the other categories, in particular demand-side and informational issues (hypothesis A).”

A) The APFI believes in professionalism of fund investing and investment consulting. We believe all those whom influence the selection of managers should operate within the same fiduciary perimeter and that the playing field should be level. We support this remedy.

Investment consultants’ recommendations are influenced by their business relationships with asset managers

Require full disclosure of business interests to trustees

“This potential remedy would involve working with trustees and investment consultants to develop an industry standard on full disclosure of business interests. Investment consultants would also have to make a full disclosure to trustees as regards all business interests that might affect - or be perceived to affect - the integrity of their advice and give rise to conflicts of interest. “

Impose measures to ensure there is stronger separation of different business areas within investment consultants

“This potential remedy would involve developing a set of business separation rules that investment consultants would be required to adhere to. The remedy could, for example, facilitate stronger business separation between investment consultancy services and fiduciary management services and the services that asset managers purchase from investment consultants (for example the organising/hosting of conferences, data and consulting services, as well as investment consultancy services).”

Investment consultants’ recommendations are influenced by hospitality

Impose limits on the value of hospitality that investment consultants are allowed to receive from asset managers

A) We believe consultants should be subject to the same regulatory regime as other professional fund investors subject to FCA FG13/1 in the UK and Anti-trust laws and DOL-fiduciary in the US. Excessive hospitality is considered a potential inducement via Anti Bribery Act.

“This potential remedy would involve working with trustees and investment consultants to develop an industry standard on managing conflicts of interest. Consultants would commit to refuse any gifts, hospitality or entertainment above a pre-agreed threshold. Consultants could also make their firms’ policies in regards to hospitality public and disclose any hospitality that could give rise to a conflict of interest, regardless of the value of such hospitality.”

A) This step is not required assuming investment consultants move within the scope of FCA Handbook and thus FG13/1. In absence of which the APFI would happily help support the creation of standards across professional fund investors.

Impose limits on the type of hospitality eg legitimate business meetings and conferences only

As above, this potential remedy would involve working with trustees and investment consultants to develop an industry standard on managing conflicts of interest. Investment consultants would need to commit to refuse any gifts, hospitality or entertainment outside a pre-agreed set of parameters (eg allow only business meetings, conferences, etc). Investment consultants would also have to make their firms’ policies in regards to

hospitality public and disclose any hospitality that could give rise to a conflict of interests to the trustees, regardless of the nature of such hospitality.

A) See response above.

Require full disclosure of hospitality received to trustees

“This potential remedy would involve working with trustees and investment consultants to develop an industry standard on managing conflicts of interest. Consultants would also have to make their firms’ policies in regards to hospitality public and disclose any hospitality to the trustees, regardless of the value and nature of such hospitality.”

A) See response above.

Impose an outright ban on hospitality

A) This is not necessary; research is a necessary component of fund selection and some research events include some hospitality. However this should be proportional to content of the event, assets under influence and the individual. This should satisfy FG13/1 and any standards created.

This potential remedy would involve banning the offer and acceptance of any gifts, hospitality or entertainment of any value and nature between investment consultants and asset managers.

A) See above response.

C. Potential remedies to address barriers to entry and expansion

We set out below potential remedies to address any AECs that we may find in relation to barriers to entry and expansion.

Introduce mandatory tendering for investment consultancy services and/or fiduciary management services

“This potential remedy would involve introducing a mandatory tendering regime for both investment consultancy services and fiduciary management services, and pension funds could also be encouraged to review services from investment consultants on a regular basis.”

A) We support this remedy.

Require divestiture of investment consultancy services

“This potential remedy would involve requiring firms to divest their investment consultancy services arm if these firms offer other services such as asset management services, etc. This remedy would seek to create a new source of competition or strengthen an existing source of competition by increasing the quantity of non-vertically integrated investment consultancy firms in the market.”

A) The APFI believes better segregation is needed as many large consultancies operate partnership structures that allow sharing of information and cross-management.

Basic FCA accreditation scheme to provide certification of smaller consultants

A) We fully support schemes designed to encourage smaller consultancy that help reduce concentration in fund manager influence.

“This potential remedy would involve recommending that the FCA develop an accreditation scheme for smaller consultants, who are currently seen as risky by trustees. This remedy would be designed to increase switching between investment consultants and lower barriers to entry and expansion.”

A) The APFI notes that many consultants have actuarial or accountancy training but no specific investment or manager selection training. APFI offers its services to support such accreditation as well as our links with other professional bodies to offer CPD schemes, and to advise which courses would support better professionalism and standards in selecting and recommending funds.

Summary

“We have identified three initial high-level hypotheses for structuring our investigation and have set out some potential remedies that may help to address any of these issues if one or more AECs are identified through our investigation.

We should emphasise that we have not found any competition concerns and both the issues and potential remedies that we have described in this document are hypothetical at this early stage of our investigation. The CMA will only put in place remedies if, following our investigation we determine that there are AECs that require remedying and there is no presumption at this stage that AECs will be found and remedies required.

This statement provides a framework to prompt parties to submit evidence and views on both the issues that we envisage being relevant at this stage and on the potential remedies that we have identified or any other potential remedies.”

The APFI thanks the CMA for the opportunity to input into this consultant of great interest to professional fund investors. November 2017.

Please contact: JB Beckett, Chartered MCSI, UK Director, Association of Professional Fund Investors. www.profundinvestors.com.

Ends.

